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In The

Supreme Court of the United States

October Term, 1986

Alioto & Alioto; Heck & Heck, Inc.; Heck Oil, Inc.; and Mark Zelezny,

Petitioners,

v.

E. F. Hutton & Co., Inc.; Kurt Feshbach; Stockbridge Partners, Inc.; Richard Jacoby; Haim Pekelis; Shearson-American Express, Inc.; Oppenheimer & Co., Inc.; and Donaldson, Lufkin and Jenrette Securities Corporation,

Respondents.

REPLY BRIEF OF PETITIONERS ALIOTO & ALIOTO; HECK & HECK, INC.; HECK OIL, INC.; AND MARK ZELEZNY IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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To the Honorable William H. Rehnquist, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

Petitioners, Alioto & Alioto; Heck & Heck, Inc.; Heck Oil, Inc.; and Mark Zelezny, hereby reply to the Joint and Consolidated Brief of Respondents in opposition to their petition for writ of certiorari as follows:

I

RESPONDENTS FAIL TO ADDRESS THE PRINCIPAL ISSUE RAISED BY THE RULE 11 AWARD: THAT THE ACTION FILED WAS NEVER FOUND FRIVOLOUS BY EITHER THE DISTRICT COURT OR THE APPELLATE COURT.

Respondents spend considerable time and energy in their opposition to petitioners' briefs in disputing issues which are not raised in those briefs, in an apparent attempt to disguise the real questions before this Court.[1] Neither petitioner Barton nor these petitioners dispute that an award may be made under Rule 11 if the court finds the pleading at issue not "well grounded in fact" (as opposed to "not warranted by existing law"), or that the district court made "findings of fact" in awarding the sanctions against petitioner Alioto. (Respondents' Brief ("R.B.") at pp. 3, 15-16.) Petitioners do not, however, as respondents suggest, seek review by this Court of the *facts* underlying the Rule 11 award. Petitioners seek review of the Ninth Circuit's *legal conclusion* that the conduct sanctioned constituted a violation of Rule 11 in the absence of a finding by either lower court that the action was not well grounded in fact.

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[1] Respondents also engage in impermissible and unsupported speculation about petitioners' motivations for filing the complaint, which this Court should ignore. (Respondents' Brief ("R.B.") pp. 3-4; *see also* Barton Reply Brief, pp. 2-3)

In this case, nearly $300,000 in Rule 11 sanctions were awarded (and affirmed) against an attorney, without warning, after only two months of actual litigation on the case itself, and before any motions to dismiss were heard or motions for class certification or summary judgment were brought, for filing a complaint whose *substantive allegations were never challenged, although they were the same as to all the named plaintiffs.* The case had barely begun when the court awarded the sanctions, and none of the procedural mechanisms available under the Federal Rules had been used to refine the pleading, narrow the issues, or make determinations on the merits of the lawsuit filed. The district court, itself, repeatedly stated that the sanctions did not go to the merits of the substantive allegations in the complaint. (Petitioners' Brief ("Alioto Brief"), p. 14.)

Instead, the sanctions were awarded because the district court disagreed with petitioner Alioto's choice of party plaintiffs and because petitioner filed the lawsuit on behalf of all those damaged by the conspiracy without talking personally to one of the class plaintiffs, and despite insinuations in a newspaper article that other Unioil shareholders were "unhappy" with the company. Based on petitioner Alioto's failure to reach the same *legal* conclusion as the Court as to the propriety of the named plaintiffs, the Court found he had not performed a reasonable inquiry into the facts underlying the class claims. The primary issue before this Court, an issue which respondents simply ignore in their opposition, is whether such conduct is sanctionable under Rule 11 where the factual and legal basis for the substantive allegations as to all the parties, including the class, are never found by either of the lower courts to be without merit.

Contrary to respondents' blithe assertion, the law is not "well settled" in the federal courts with regard to the "well-grounded-in-fact" requirement of Rule 11. (R.B. at pp. 15, 20-23.)[2] In the four years since the Rule was amended in August 1983, commentators throughout the legal community have expressed deepening and increasing concern about the continued uncertainty surrounding the Rule's application by the federal courts. In the most recent article to come to petitioners' attention, Gregory P. Joseph observed that the disagreement among federal judges on "precisely what conduct constitutes a violation" renders practice under the Rule like "negotiating a mine field. You know there will be an explosion if you step on a mine. The trouble is, you don't know where the mines are." Joseph, "The Trouble With Rule 11—Uncertain Standards and Mandatory Sanctions," *A.B.A. Journal* 87, 89, August, 1987.

Although *some* uncertainty about what conduct is sanctionable under Rule 11 may be inevitable, because each case will rest on its own facts and legal theories, it seems at a minimum the Rule requires courts to make a determination on the merits of the pleading in question before sanctions are appropriate. It is critical to this case that neither the district court nor the appellate court took issue with the substantive conspiracy allegations in the complaint filed against the respondent brokers. No one, including respondents, disputes that *both* Unioil and its shareholders would be damaged by a concerted scheme

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[2] Respondents mischaracterize the abbreviated survey petitioners offered the Court in their brief. Petitioners do not pretend that every conflict or inconsistency demonstrated by the cases cited is "raised by this case." (R.B. at p. 20.) The cases are cited to illustrate the nationwide confusion about Rule 11 and to demonstrate that, because this case is typical of that confusion, this Court should grant a writ of certiorari to review a federal question of national importance.

to depress the price of Unioil's stock if such a conspiracy were proven.

Rule 11 is designed to deter the filing of meritless lawsuits. No finding was ever made that the allegations in the complaint were meritless as to *any* plaintiff, including the class. All that the court found was that Mark Zelezny, the only class plaintiff "with an appearance of independence from Unoil," could not adequately represent the shareholder class because, in the court's opinion, his experience was different from that complained of in the complaint. As discussed in the Alioto Brief, based on the factual information he reviewed and his theory of the case, Mr. Alioto concluded that both Mr. Zelezny and the Heck Companies were proper class plaintiffs, absent a showing that they themselves participated in the conspiracy.[3] (Alioto Brief, pp. 16-17.)

The court's contrary conclusion in this regard does not render the complaint and its substantive allegations meritless and should not have been the basis of a sanctions award. Even if, after a full briefing on the class certification issues, Mr. Zelezny was still found to be an insufficient class plaintiff, sanctions would be indicated *only* if Mr. Alioto had *no* reasonable basis for including him. Indeed, where a class plaintiff is mistakenly included, the remedies are numerous under the Federal Rules. Another class plaintiff could be substituted, the class could be decertified, or other nonpunitive measures could be used to remedy the situation. Where a meritori-

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[3] In the context of a fraud-on-the-market case, Mr. Zelezny's deposition testimony that he thought Unioil was trading at a fair price only *supports* his reliance on the integrity of the market. In addition, contrary to respondent's insistence that he bought Unioil stock in the face of the voluminous shortselling, respondents simply disregard the fact that Mr. Zelezny also *sold* his stock at a tremendous loss when the scheme to depress the stock succeeded.

ous action has been filed, the fact that parties may later have to be realigned or substituted does not warrant sanctions under Rule 11. The law is not black and white, and differing interpretations are the law's lifeblood. Where the court awards sanctions based on its disagreement with counsel's legal analysis about whom he can include in the suit, the chilling effect of such an application of the Rule is manifest.

The same is true with regard to the shareholder lawsuits filed *after* the complaint at issue, which raised a question about the continued representation by counsel of some of the parties. The fact that the later shareholder actions posited a *different* legal theory for the decline of Unioil's stock does not reflect on the merits of the action against the brokers. Alternative and even inconsistent theories of liability are commonly pursued in the federal courts in the same action, under Rule 8. In this case, the fact that a new theory was alleged in a *different* action does not make the theory in the original action erroneous. The time for determining which theory was correct was at the conclusion of the cases, not on a motion to dismiss voluntarily on procedural grounds only two months after the pleading was filed. Indeed, no actual conflict ever existed, and the potential conflict of interest was resolved by substituting new counsel for Unioil and Richards, a commonplace procedure for dealing with such a situation. Moreover, *respondents* were not prejudiced in any way by the fact that the potential conflict which arose later required the substitution of new counsel for some of the parties.

Furthermore, the Ninth Circuit's affirmance of the sanctions in this case operates to discourage attorneys from taking prompt corrective action once a circumstance arises which indicates claims should be withdrawn. In-

deed, the district court implied that sanctions were not appropriate where plaintiffs dismissed their "representative claims once it appeared appropriate to do so" (when the shareholder actions were filed) (App. B-6), and where they had "simply withdraw[n] claims, if they legitimately believed the class aspects of the complaint were well grounded in fact." (App. B-9.) As petitioners, in fact, withdrew their claims when it appeared appropriate to do so, one is hard-pressed to understand the court's self-contradictory Rule 11 award. It is noteworthy that Richards and Unioil escaped the district court's sanctions by withdrawing from the motion for voluntary dismissal through new counsel and simply allowing their claims to lie fallow. Ironically, Alioto was punished for initiating prompt corrective action.[4]

In the final analysis, the Ninth Circuit, in affirming the district court's Rule 11 award, has created a new "prong" to the Rule—the reasonable inquiry prong—which the district courts may now apply in isolation and without regard to the merits of the pleading at issue. By approving the award without regard to the merits of the lawsuit, the Ninth Circuit's decision in this case could lead to the chilling result that courts could sanction an attorney who files a *meritorious action* simply because the court finds fault with the attorney's prefiling investigation. As the Rule's purpose is to conserve judicial resources by deterring the filing of groundless actions, to

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[4] Contrary to respondents' contention, there was nothing improper about petitioners' seeking dismissal *without* prejudice and neither the district court nor the Ninth Circuit so held. (R.B. at p. 18) Moreover petitioner's purported "improper attempt to disengage without cause from class discovery" was *not* an issue in this case because that dispute was resolved in an earlier proceeding before the U.S. Magistrate. (App. B-3, para. 11.) Respondents' reference to the proceeding is a barefaced attempt to prejudice this Court.

allow the Ninth Circuit's expanded application in this case could lead to an "Orwellian" interference by the courts in every exercise of an attorney's professional judgment. As demonstrated by the authorities offered to the court by petitioners, uncertainty about what conduct may subject attorneys to sanctions is rampant nationwide. Where attorneys cannot predict when the sanctioning power of the federal courts will be wielded against them, their effectiveness as advocates, and advocacy itself is irreparably damaged. Rule 11 serves a good and useful purpose only if its application is confined to punishing abuses of the judicial process by the filing of baseless claims. The Rule in this case was not applied to conduct governed by it and, in fact, worked to prolong the litigation and increase the burdens on the judicial system. Petitioners respectfully request this Court to review the sanctions awarded in this case and to set forth guidelines regarding Rule 11's application by the courts in the future.

II

RESPONDENTS IGNORE THE LEGAL PREJUDICE SUFFERED BY ALL PETITIONERS DUE TO THE NINTH CIRCUIT'S HOLDING FOR THE FIRST TIME THAT THE RULE 41(a)(2) AWARD WAS NOT APPEALABLE.

Despite the clear fact that petitioners were effectively denied *any* review of the reasonableness of the Rule 41(a)(2) award of nearly $165,000 for only two months of litigation, respondents assert that "no important issues of federal law" are implicated by the Ninth Circuit's holding *for the first time* that such an award is not reviewable on appeal. In taking such a position, respondents simply ignore that the holding amounts to a denial of due process. The Ninth Circuit's observation that review might be obtained on a writ of mandamus is cold

comfort to appellants who have already undertaken the expenditure of time and money on an appeal, and where the court from whom they must seek the writ has impliedly approved the award. Moreover, as petitioner Barton cogently argues in his petition and reply, to limit appellate review solely to a writ proceeding could easily lead to unjust and inconsistent results due to the differing status of the parties involved. Even were plaintiff petitioners able to obtain review of the Rule 41(a)(2) award in a writ proceeding, and were they able to obtain a reversal or reduction of the award, petitioner Alioto would be prejudiced because the Rule 11 award, in which the Rule 41(a)(2) award is subsumed, is final as to him.

Nor, as respondents repeatedly assert, did petitioners "acquiesce" to the Rule 41(a)(2) award in light of their immediate appeal of the award. (Alioto Brief, pp. 27-28.) Indeed, the logic of the Ninth Circuit's holding in this case that a failure by a party against whom a Rule 41(a)(2) award is made to withdraw the motion for voluntary dismissal is deemed "acquiescence" to the award is questionable. (App. A-8.). Withdrawal from the request for voluntary dismissal was impossible in this case, even in the face of an outrageous and burdensome condition to dismissal, due to the district court's ruling that petitioner plaintiffs were inappropriate class representatives. Indeed, the Ninth Circuit's holding that failure to withdraw from a motion for voluntary dismissal is henceforth deemed acceptance of the conditions in that circuit, sets up a presumption that would make review of the reasonableness of the award nearly impossible to obtain even in a writ proceeding. Certainly the Ninth Circuit's retroactive application of its new holding redounds to the prejudice of all the petitioners.

Moreover, dismissal with prejudice was not a viable "option," as respondents contend, where the dismissal sought is based on the *form* of the litigation, rather than on the merits. To force plaintiffs to give up important legal rights to obtain review of the award on appeal, is a drastic requirement which should be imposed sparingly, if at all.

Similarly, respondents' contention that there is no conflict among the circuits with regard to the appealability of the reasonableness of a Rule 41(a)(2) award is clearly belied by the cases cited by petitioners. There is clearly a split of authority among the circuits as to whether attorneys' fees and costs awarded under Rule 41(a)(2) constitute sufficient legal prejudice to be appealable. While the Ninth Circuit held for the first time in the *Unioil* case they are not, the District of Columbia and Fifth Circuits have held they are. (Alioto Brief, pp. 27-28.) Given the due process implications of the Ninth Circuit's decision in *Unioil* as to petitioners, the conflict among the circuits should, by itself, be sufficient reason for this Court to review the issue.

The fact that the Ninth Circuit impliedly upheld the reasonableness of the Rule 41(a)(2) award in upholding the Rule 11 award raises additional problems because different factors are taken into account in making awards under Rule 11 and Rule 41(a)(2). Under 41(a)(2), only those fees and costs which were incurred for work which would *not be useful* in succeeding litigation should be awarded. In this case, contrary to respondents' contention, at the time the award was made, Unioil and M. L. Richards indicated to the district court their intention to file new pleadings and to pursue their claims against the brokers. (App. B-9.) Thus, at the time the award was made, the usefulness of the work done up to that point

should have been but was not considered. The fact that Unioil and Richards would not subsequently prosecute their claims was not known when the award was made. The award should have been made and should be accorded appellate review in light of the circumstances known at that time, not in light of events which unfolded later.

Finally, respondents' statement that the Rule 41(a)(2) award was made "without regard to plaintiff's or its counsel's good or bad faith, the merits of the pleadings, or any conduct or misconduct of counsel," is simply untrue. (Resp. Brief, at p. 24, citing *G.A.F. v. Transamerica Insurance Co.*, 665 F.2d 364, 367 (D.C. Cir. 1981) and *McLaughlin v. Cheshire*, 676 F.2d 855 (D.C. Cir. 1982).) Both lower courts clearly took these factors into consideration in awarding and affirming the entire amount of the awards under both Rules against petitioner Alioto. Under the rule in *G.A.F.* and *McLaughlin* this was an impermissible use of Rule 41(a)(2) and should be reversed on that ground, alone.

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CONCLUSION

For the reasons set forth in all the petitioners' briefs, these petitioners respectfully request this Court to grant their petition for a writ of ceritorari in this case.

DATED: August 27, 1987

Respectfully submitted,

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